



Proposed Regulation Agency Background Document

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| Agency name | Department of Mines, Minerals and Energy |
| Virginia Administrative Code (VAC) citation | 4 VAC 25-165 |
| Regulation title | Regulations Governing the Use of Arbitration to Resolve Coalbed Methane Gas Ownership Disputes |
| Action title | New regulation to administer arbitration process for coalbed methane gas ownership disputes |
| Date this document prepared | July 20, 2011 |

This information is required for executive branch review and the Virginia Registrar of Regulations, pursuant to the Virginia Administrative Process Act (APA), Executive Orders 14 (2010) and 58 (1999), and the *Virginia Register Form, Style, and Procedure Manual*.

Brief summary

In a short paragraph, please summarize all substantive provisions of new regulations or changes to existing regulations that are being proposed in this regulatory action.

Chapter 442 of the 2010 Acts of Assembly directs the Virginia Gas and Oil Board (VGOB) to adopt regulations to implement the arbitration process created in that act within 280 days of its enactment. VGOB adopts its regulations through the Department of Mines, Minerals and Energy (DMME). This regulation establishes the guidelines for the arbitration process. Some of the key provisions include how arbitrations are funded, the qualifications of the arbitrator, and procedures associated with the arbitration itself. Except for one minor change, these proposed regulations are identical to the existing emergency regulations currently in effect.

Acronyms and Definitions

Please define all acronyms used in the Agency Background Document. Also, please define any technical terms that are used in the document that are not also defined in the "Definition" section of the regulations.

DMME = Department of Mines, Minerals and Energy

VGOA = Virginia Gas and Oil Act
 VGOB = Virginia Gas and Oil Board

Legal basis

Please identify the state and/or federal legal authority to promulgate this proposed regulation, including (1) the most relevant law and/or regulation, including Code of Virginia citation and General Assembly chapter number(s), if applicable, and (2) promulgating entity, i.e., the agency, board or person. Describe the legal authority and the extent to which the authority is mandatory or discretionary.

As mentioned above, [Chapter 442 of the 2010 Acts of Assembly](#) mandates these regulations. Also, the Director of DMME is generally empowered with regulatory authority under § [45.1-161.3](#) and § [45.1-361.4](#) of the Code of Virginia. (Code). VGOB possesses authority to issue regulations under § [45.1-361.15](#) of the Code. On June 14, 2011, the VGOB voted to adopt proposed regulations pursuant to Chapter 442 of the 2010 Acts of Assembly. On July 19, 2011, the VGOB voted to make one minor change to the proposed regulations.

Purpose

Please explain the need for the new or amended regulation by (1) detailing the specific reasons why this regulatory action is essential to protect the health, safety, or welfare of citizens, and (2) discussing the goals of the proposal, the environmental benefits, and the problems the proposal is intended to solve.

The purpose of this regulation is to administer the arbitration process mandated in Chapter 442 of the 2010 Acts of Assembly. The act creates a voluntary arbitration process for parties with conflicting claims of ownership of coalbed methane gas. Currently, there is approximately \$26 million in royalties held in escrow, most of which is due to unresolved claims of ownership. Creating an arbitration system that is an effective alternative to litigation can help reduce the amount of funds in escrow. Emergency regulations are currently in effect. To date, VGOB has not received a request for arbitration.

Substance

Please briefly identify and explain new substantive provisions (for new regulations), substantive changes to existing sections or both where appropriate. (More detail about all provisions or changes is requested in the "Detail of changes" section.)

The regulation will establish the arbitration process. It will detail how interest is calculated to determine if sufficient funds are available to fund the arbitration, how the process works, and what happens once a determination is issued.

Issues

Please identify the issues associated with the proposed regulatory action, including:
 1) *the primary advantages and disadvantages to the public, such as individual private citizens or businesses, of implementing the new or amended provisions;*
 2) *the primary advantages and disadvantages to the agency or the Commonwealth; and*
 3) *other pertinent matters of interest to the regulated community, government officials, and the public.*

If the regulatory action poses no disadvantages to the public or the Commonwealth, please indicate.

The primary advantage of this statutorily mandated regulation is that landowners and mineral owners in Southwest Virginia have another potential avenue to voluntarily resolve disputes over the ownership of coalbed methane gas. Another potential benefit to citizens, relevant businesses and the Commonwealth would be a decrease of funds currently held in escrow as the result of arbitration determinations. There are no disadvantages to this regulation.

Requirements more restrictive than federal

Please identify and describe any requirements of the proposal, which are more restrictive than applicable federal requirements. Include a rationale for the more restrictive requirements. If there are no applicable federal requirements or no requirements that exceed applicable federal requirements, include a statement to that effect.

There are no applicable federal requirements.

Localities particularly affected

Please identify any locality particularly affected by the proposed regulation. Locality particularly affected means any locality which bears any identified disproportionate material impact which would not be experienced by other localities.

Though the wells that produce the gas in question are located in Southwest Virginia, no locality will be particularly affected by this regulation. Localities will continue to receive severance taxes from gas production, it is only the royalties that are placed into escrow.

Public participation

Please include a statement that in addition to any other comments on the proposal, the agency is seeking comments on the costs and benefits of the proposal and the impacts of the regulated community.

In addition to any other comments, the board/agency is seeking comments on the costs and benefits of the proposal and the potential impacts of this regulatory proposal. Also, the board is seeking information on impacts on small businesses as defined in § 2.2-4007.1 of the Code of Virginia. Information may include 1) projected reporting, recordkeeping and other administrative costs, 2) probable effect of the regulation on affected small businesses, and 3) description of less intrusive or costly alternative methods of achieving the purpose of the regulation.

Anyone wishing to submit written comments may do so via the Regulatory Townhall website, www.townhall.virginia.gov, or by mail, email or fax to **Michael A. Skiffington, Program Support Manager, 1100 Bank Street, 8th Floor, Richmond, VA 23219. Phone 804-692-3212, Fax 804-693-3237, e-mail - michael.skiffington@dmme.virginia.gov**

Written comments must include the name and address of the commenter. In order to be considered, comments must be received by the last date of the public comment period. A public hearing will be held

and notice of the public hearing may appear on the Virginia Regulatory Town Hall website (www.townhall.virginia.gov) and the Commonwealth Calendar. Both oral and written comments may be submitted at that time.

Economic impact

Please identify the anticipated economic impact of the proposed new regulations or amendments to the existing regulation. When describing a particular economic impact, please specify which new requirement or change in requirements create the anticipated economic impact.

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| <p>Projected cost to the state to implement and enforce the proposed regulation, including (a) fund source, and (b) a delineation of one-time versus on-going expenditures.</p> | <p>There is no added cost to the state. The enabling statute specifies that interest from the general escrow account is to be used to fund the cost of arbitration.</p> |
| <p>Projected cost of the <i>new regulations or changes to existing regulations</i> on localities.</p> | <p>There is no cost to the localities. Most localities in the Commonwealth will be completely unaffected by this regulation.</p> |
| <p>Description of the individuals, businesses or other entities likely to be affected by the <i>new regulations or changes to existing regulations</i>.</p> | <p>This regulation will primarily affect certain gas owners in Southwest Virginia, gas companies, and those who own coal interests.</p> |
| <p>Agency’s best estimate of the number of such entities that will be affected. Please include an estimate of the number of small businesses affected. Small business means a business entity, including its affiliates, that (i) is independently owned and operated and (ii) employs fewer than 500 full-time employees or has gross annual sales of less than \$6 million.</p> | <p>Due to family heirships, there could be anywhere from 8,000 to 12,000 entities affected by this regulation, though VGOB has not yet received a single request for arbitration.</p> <p>Potential affected small businesses could include land management groups or small coal companies. Highly estimated, the number is believed to be less than 150.</p> |
| <p>All projected costs of the <i>new regulations or changes to existing regulations</i> for affected individuals, businesses, or other entities. Please be specific and include all costs. Be sure to include the projected reporting, recordkeeping, and other administrative costs required for compliance by small businesses. Specify any costs related to the development of real estate for commercial or residential purposes that are a consequence of the proposed regulatory changes or new regulations.</p> | <p>Though it is not required, citizen landowners may incur legal expenses if they choose to have representation at an arbitration. Oil and gas companies typically already have attorneys on retainer.</p> |
| <p>Beneficial impact the regulation is designed to produce.</p> | <p>This regulation is designed to define the means by which parties can resolve coalbed methane gas ownership disputes through arbitration, thus decreasing the amount of funds currently held in escrow.</p> |

Alternatives

Please describe any viable alternatives to the proposal considered and the rationale used by the agency to select the least burdensome or intrusive alternative that meets the essential purpose of the action. Also, include discussion of less intrusive or less costly alternatives for small businesses, as defined in §2.2-4007.1 of the Code of Virginia, of achieving the purpose of the regulation.

This regulation is mandated by statute, thus there are no alternatives.

Regulatory flexibility analysis

Please describe the agency’s analysis of alternative regulatory methods, consistent with health, safety, environmental, and economic welfare, that will accomplish the objectives of applicable law while minimizing the adverse impact on small business. Alternative regulatory methods include, at a minimum: 1) the establishment of less stringent compliance or reporting requirements; 2) the establishment of less stringent schedules or deadlines for compliance or reporting requirements; 3) the consolidation or simplification of compliance or reporting requirements; 4) the establishment of performance standards for small businesses to replace design or operational standards required in the proposed regulation; and 5) the exemption of small businesses from all or any part of the requirements contained in the proposed regulation.

This regulation is mandated by statute. The arbitration process is voluntarily and designed to allow parties in dispute an alternative to litigation.

Public comment

Please summarize all comments received during the public comment period following the publication of the NOIRA, and provide the agency response.

| Commenter | Comment | Agency response |
|------------------|--------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------|
| "Jonathan" | Just wondering if anyone knows how the NFL Lockout is going to effect the arbitration regarding methane gas. | This regulation is completely unrelated to the NFL lockout. |

Family impact

Please assess the impact of the proposed regulatory action on the institution of the family and family stability including to what extent the regulatory action will: 1) strengthen or erode the authority and rights of parents in the education, nurturing, and supervision of their children; 2) encourage or discourage economic self-sufficiency, self-pride, and the assumption of responsibility for oneself, one’s spouse, and one’s children and/or elderly parents; 3) strengthen or erode the marital commitment; and 4) increase or decrease disposable family income.

This regulation will have no impact on the family.

Detail of changes

Please list all changes that are being proposed and the consequences of the proposed changes. If the proposed regulation is a new chapter, describe the intent of the language and the expected impact if implemented in each section. Please describe the difference between the requirements of the new provisions and the current practice or if applicable, the requirements of other existing regulations in place.

If the proposed regulation is intended to replace an emergency regulation, please list separately (1) all provisions of the new regulation or changes to existing regulations between the pre-emergency regulation and the proposed regulation, and (2) only changes made since the publication of the emergency regulation.

With one exception in Section 60, the proposed regulations are identical to the existing emergency regulations.

| Section number | Proposed requirements | Other regulations and law that apply | Intent and likely impact of proposed requirements |
|-----------------------|------------------------------|---------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10 | Definitions | N/A | This section serves to define terms. |
| 20 | Authority and applicability | VGOA | This section details the authority of VGOB to promulgate the regulation. |
| 30 | Costs of arbitration | VGOA | This section details how arbitrations are funded. |
| 40 | Qualification of arbitrators | VGOA | This section details how individuals are qualified to serve as arbitrators. |
| 50 | Agreement to Arbitrate | VGOA | This section specifies that the agreement to arbitrate must be submitted on a form prescribed by DMME. This is to ensure all the necessary information is provided. |
| 60 | Conflicts of Interest | VGOA | This section specifies the circumstances in which an arbitrator would not be allowed to participate in an arbitration. |
| 60 | Conflicts of Interest | VGOA | One clause in this section was stricken as it was more restrictive than the limitations placed in § 45.1-361.22:1(A). |
| 70 | Location | VGOA | This section specifies how the venue for an arbitration is chosen. |
| 80 | Postponement of Arbitration | VGOA | This section specifies the process for requesting postponement of an arbitration. |
| 90 | Discovery | VGOA | This section specifies the pre-arbitration discovery process. |
| 100 | Extension of Arbitration | VGOA | This section details how the six month time period for a determination can be extended. |

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| 110 | Determination of Arbitrator | VGOA | This section specifies the requirements of the determination of the arbitrator. |
| 120 | Ex Parte Communications | VGOA | This section prohibits any communication between one claimant and the arbitrator without the presence of the opposing claimant. |
| 130 | Fees | VGOA | This section specifies the hourly fee to be paid to the arbitrator. |
| 140 | Disbursement of Proceeds | VGOA | The section specifies the process by which a petition for disbursement shall be sent to the VGOB following a final determination. |